BEFORE

THE PUBLIC SERVICE COMMISSION OF

SOUTH CAROLINA

DOCKET NO. 90-1-G - ORDER NO. 90-433

APRIL 11, 1990

IN RE:	Annual Review of Purchasing Practices and Purchased Gas Adjustment of South Carolina Pipeline Corporation.	ORDER APPROVING PURCHASING PRACTICES AND PURCHASED GAS ADJUSTMENT

This docket was initiated pursuant to Commission Order No. 87-1122, issued on October 5, 1987, to review the natural gas purchasing practices and purchased gas adjustment of South Carolina Pipeline Corporation (Pipeline). The Commission Staff monitors Pipeline's gas purchasing practices on a monthly basis. In Order No. 87-1122, the Commission established a policy of conducting an additional formal review of Pipeline's purchasing practices and purchased gas adjustment each year. Similar reviews are conducted annually for other similarly situated companies.

In response to the notice of public hearing in this docket, the South Carolina Department of Consumer Affairs (the Consumer Advocate), Lancaster County Natural Gas Authority, York County Natural Gas Authority, City of Orangeburg, Chester Natural Gas Authority, and South Carolina Electric & Gas Company (SCE&G) intervened. The Commission held public hearings in the docket on March 7, 1990. Pipeline, the Commission Staff and the intervenors appeared through counsel. The Commission heard testimony from Mr.

Ray Kightlinger, witness for Pipeline and Mr. Brent L. Sires, witness for the Commission.

Pipeline's testimony

Changes in the natural gas industry have affected Pipeline's purchasing practices in recent years. Since the winter of 1982-1983, the gas industry has been faced with a significant load loss in the industrial market through competition with other energy sources, specifically heavy fuel oil. To overcome this problem, interstate pipeline companies and federal regulatory agencies have worked toward moving gas to these markets at lower prices unbundled by most of the fixed charges included in demand rates. The result has been development of transportation services and release of gas supplies by interstate pipeline companies.

These changes have allowed industry to continue to be able to burn natural gas at a much lower rate providing savings in maintenance costs as well as fuel charges. The retention of industrial load by the gas utilities has a significant benefit for the commercial and residential customers through coverage of some fixed and variable costs. Pipeline has been able to reduce or maintain levels of gas costs for all customers while retaining industrial loads for the system benefit. For example, the twelve month average cost of gas has varied only 11.3% from high to low over the seven years Pipeline has been buying spot market gas for its system and industrial sales programs.

In response to the changes in the natural gas industry and its regulation, Pipeline has taken a very active role in proceedings at

FERC. Pipeline has negotiated purchases of large volumes of gas on the spot market and arranged for its transportation. Pipeline's policies and procedures in natural gas purchasing involve bids for spot market gas as well as a responsible purchasing policy of purchasing some volume of firm service gas from its pipeline suppliers under the demand commodity rate. This gas is available through long term producer contracts between Transco, Southern and their suppliers and is necessary for meeting Pipeline's customers' peak day needs. Pipeline is careful to fulfill its responsibility to be a reliable supplier of natural gas in meeting its customers' firm requirements. Long-term contracts with its interstate pipeline suppliers are an important facet of that reliability.

Pipeline's spot market purchases during the past few years have increased to the point that they amounted to 52.9% of the total in 1986 to 70.8% in 1989. These purchases allowed Pipeline and its resale customers to maintain service to most of their large industrial customers. As stated above, Pipeline has been able to maintain an overall stability of its weighted average cost of gas (WACOG) such that the twelve month average gas cost for the period 1983 through 1989 has varied only within an 11.3% range.

Commission Order No. 77-399 established a cost of gas recovery method for Pipeline. This procedure calculates a WACOG monthly. All gas service charges billed to Pipeline for its gas supplies entering the system are totaled and divided by the gas volume to determine the WACOG. The margins approved by this Commission are added to the WACOG to determine the customers' gas rate.

Direct interruptible sales comprised approximately 24.7% of Pipeline's annual sales in 1989. Under its WACOG pricing method, these customers pay a portion of the fixed demand charges from its pipeline suppliers. Also, the margin revenue from these customers helps cover Pipeline's fixed costs. Without such sales, the rates to its resale customers would increase significantly. Through Pipeline's gas cost recovery method, the gas costs are recovered as precisely as possible for the month in which the charges are made.

According to Mr. Kightlinger, the ISPR method of allocating gas supplies is fair and evenhanded. It significantly benefits Pipeline's firm supply customers. The method that Pipeline uses properly accounts for the different requirements placed in its systems by its different customer classes. It properly accounts for the different sources of supply that are required for different customer classes.

Pipeline maintains firm gas supplies because on very cold days when natural gas systems operate at near peak levels, firm gas is the only gas available. Other sources of supply, including transportation of spot gas, are curtailed or denied. On peak days, the only way that Pipeline can guarantee service to its firm customers is through firm gas supplies. Pipeline's firm customers are by and large local distribution systems, although there are some direct industrial customers that purchase firm gas. Local distribution systems may be investor-owned, however, the majority are governmentally owned and operated. These systems are resellers of natural gas. They use the firm gas they purchase to serve residential and commercial customers and a limited number of industrial customers.

Pipeline's second principal source of supply is spot market gas. Spot gas is gas that Pipeline itself purchases in the gas fields. Pipeline then contracts with interstate pipelines to transport this gas to South Carolina. Except in winter months spot gas is typically much cheaper than firm gas. Spot gas is not a reliable source of supply and Pipeline can only obtain it on an "as available" basis. Interstate pipelines have multiple sources of supply and often have multiple routes to bring gas to their customers. Interstate pipelines usually can compensate for the loss of supply from a particular well or group of wells with little disruption. A spot market purchaser does not always have that same ability.

Pipeline has two principal classes of customers: firm and interruptible. Pipeline's interruptible customers are industrial customers who have alternate fuels available to them. They can quickly switch to those fuels if the prices Pipeline charges for gas are higher than the price of their alternate fuel. A reduction in interuptible sales would not lead to any significant reduction in Pipeline's purchases of firm gas. Pipeline's purchases of firm gas are to protect its firm customers. Losing competitive customers would merely reduce spot gas purchases.

Pipeline each month assigns to each competitive sale customer the highest cost gas that allows Pipeline to make the sale and earn the margin established in its contract. For example, if its competitive price is $2.50 per dekatherm and its margin for the customer is set as $.25, then Pipeline would assign to that customer the gas whose cost to Pipeline is closest to price to $2.25. If firm gas were priced at $2.25, it would assign firm gas prices to the interruptible customer. Pipeline testified that there have been months when all of its firm gas purchases were assigned to competitive customers and firm customers were assigned nothing but spot gas for pricing purchases. However, Pipeline could not actually attempt to meet its firm customers' demands with spot gas purchases. Spot gas alone is too unreliable as it may not be available at all during the winter months when its firm customers needs are greatest.

Pipeline's interruptible customers make no contribution to peak demand which is the reason they pay no demand charges. On peak days, their supplies are curtailed. On peak days interruptible customers are squeezed off the system.

As a result of the ISPR program, Pipeline's competitive sales reduce the rates it charges to its firm customers. Under this program for each dekatherm of gas sold to interruptible customers, a contribution to Pipeline's revenue is assumed. That assumed revenue reduces the revenue that otherwise would have to be collected from firm customers. Under this methodology, the rates set for firm customers are reduced by the revenue attributable to the gas sold to its industrial customers during the test year. It also ensures that low cost spot gas not needed to make industrial sales is allocated to firm customers. It ensures that the highest cost gas possible is absorbed by interruptible sales.

The higher volume of competitive sales that Pipeline has, the greater purchasing power Pipeline can exert in the interruptible gas markets. The additional purchasing power allows Pipeline to obtain gas at better prices and on better terms than it might obtain otherwise. Competitive sales are interruptible sales. If all Pipeline's sales were to firm customers, Pipeline's participation in the interruptible market would be a small fraction of what it is today. By the same token, the more competitive customers Pipeline supplies, the greater proportion of its gas can be interruptible gas. The more spot gas Pipeline purchases, the better able it is to spread its risk in the spot market so that the failure of any one supplier or group of suppliers does not interfere with Pipeline's overall service. In many instances, Pipeline has been able to obtain reduced interruptible gas prices by demonstrating to suppliers that it could meet the competitive fuel price of a specific customer only if a supplier lowered his price. Under a gas cost averaging method, that type of bargaining, and the resulting low prices, would not be available. Pipeline has elected to enter into monthly contracts as opposed to long-term contracts for spot market supplies. Pipeline testified that they do not see any longer term contracts that would give them a cheaper source of supplies than they can provide their customers by dealing on the monthly spot market.

Pipeline testified that it should be allowed to continue the policies that it is now following in regard to gas supply. To maintain the industrial service so important to Pipeline's system it must continue purchasing gas on the spot market and sell it as necessary through the ISPR program. It is also prudent for Pipeline to continue buying a reasonable level of supply through its pipeline supplier firm contracts in order to ensure a reliable supply for its firm customers during peak load conditions of the winter.

As to gas cost recovery, Pipeline testified that the customers using gas on a monthly basis are paying the current costs. Pipeline will continue its active role in proceedings before the FERC and requests that the Public Service Commission Staff also take a more visible role to protect the interests of the gas customers in South Carolina and enable a continued rapid response to changes in regulatory matters at the federal level.

Pipeline testified that it acts in the collective best interests of its resale customers and can be relied on to do a prudent, just and reasonable job of gas purchasing. If Pipeline and its resale customers were to compete for gas supplies, the price and reliability could not be improved; however, some purchasing power would be lost and unnecessary duplicative costs would be incurred. Pipeline testified that it is in the public interest that it continue to be relied on by its resale customers for natural gas supply.

Pipeline was asked on cross-examination to discuss any supply or operational problems it encountered during the peak day this past December. One of Pipeline's suppliers failed to deliver

Pipeline's total quantity of gas because it had some cold weather problems but Pipeline was able to take gas out of storage to replace those supplies, so Pipeline had some flexibility that some other customers were not able to draw upon. Pipeline got through the period by using its supplemental supplies such as propane air in its LNG plant, vaporizing the liquefied natural gas and feeding it into the system. With all of Pipeline's storage available to it, it was able to come through the cold weather properly. The interstate suppliers had some major problems during that period, but Pipeline's spot market supplies were not curtailed during those peak days, probably relating to the fact that Pipeline was not buying any offshore gas in the spot market.

Staff's testimony

The Commission Staff's witness, Mr. Sires, testified that the gas cost recovery procedure of Pipeline provides for an accurate match of costs incurred with cost recovered both in terms of dollar amounts and time periods. The present gas cost recovery procedure of Pipeline is not used for all its customers. The gas costs to interruptible customers whose purchases are made under the industrial sales program are separated from the weighted average cost of gas calculation. Mr. Sires testified that Pipeline should be allowed to continue implementation of the industrial sales program because the prices of the alternate fuels continue to be very volatile and Pipeline needs an approved program in place to alleviate the impact of lost sales to industrial customers. Spot market gas of an interruptible nature is not reliable for firm service in the winter months because of transportation problems. Pipeline has to rely on CD gas to meet its firm obligations. Southern's service obligations require it to maintain sufficient reserves to meet the entitlements of its resale customers whenever they choose to buy it. In order for Southern to meet its service obligations, it has to acquire long-term gas supplies. Pipeline, acting in a prudent manner, should make purchases of CD gas to ensure adequate and reliable supplies to meet the requirements of its firm customers. If Pipeline, as well as other customers on the Southern system, did not make CD purchases, this would jeopardize reliable supplies during the winter months.

Pipeline's contract demand entitlements with its suppliers and its peaking capabilities are sufficient to meet the requirements of its firm customers. However, Pipeline should examine its firm supply capabilities very closely, especially with regard to future growth on the system and the peak established in December.

Pipeline has been very active on the spot market and should continue that role. The spot market plays a vital role in providing LDC's natural gas supplies at a price competitive with the alternate fuels of their interruptible customers as well as reducing costs to high priority customers. However, this gas is generally less reliable than the gas obtained through a long-term purchase contract with pipeline supplier; therefore, Mr. Sires is reluctant to recommend total reliance on spot market supplies to meet the requirements of the firm customers.

Mr. Sires found that Pipeline is meeting its responsibility of maintaining adequate supplies at just and reasonable costs. Pipeline continues its attempts to get the best terms available in its negotiations with its suppliers and in proceedings at FERC.

Based on the evidence in the record, the Commission makes the following findings and conclusions:

1. Pipeline is a natural gas utility subject to regulation by this Commission.

2. Pipeline has prudently obtained natural gas supplies as required to serve its customers.

3. Pipeline has applied its gas cost recovery mechanisms fairly and accurately and use of these mechanisms has resulted in a precise matching of gas costs with recovery of those costs through rates.

4. Pipeline has responded quickly and responsibly to changes in natural gas markets resulting from the regulatory restructure of the natural gas industry at the federal level.

5. Pipeline is prudent in purchasing a high level of spot market gas.

6. Pipeline also is prudent in purchasing some volume of firm service gas from its pipeline suppliers to maintain reliability of service.

7. It is appropriate that Pipeline continue to participate actively in FERC proceedings where its gas supply costs are determined.

8. Pipeline's retention of industrial load due to the ISPR program has a significant benefit for the commercial and residential customers through coverage of some fixed and variable costs.

IT IS THEREFORE ORDERED:

1. That the gas purchasing practices and purchased gas adjustment clause of South Carolina Pipeline Corporation are approved.

2. That this Order shall remain in full force and effect until futher Order of the Commission.

BY ORDER OF THE COMMISSION:

Caroline H. Maass
Chairman

ATTEST:

Charles Dalton
Executive Director

(SEAL)